

HOW STATUTORY CIVIL LIABILITY IS ATTRIBUTED TO A COMPANY: AN AUSTRALIAN PERSPECTIVE FOCUSING ON CIVIL LIABILITY FOR INSIDER TRADING BY COMPANIES

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Where human servants of a company engage in insider trading activities in the course of their employment, the problem may arise as to, inter alia, the civil liability of the company. Questions on the ways in which the act and the knowledge of the person(s) who did the act and/or had the relevant knowledge may be attributed to the employing company will be at issue in determining the company's liability. This article makes an attempt to answer these questions. The article discusses the reasons why rules of agency will only have limited applications in insider trading liability attribution and how the tests that the Privy Council stipulated in Meridian Global Funds Management Asia Ltd v Securities Commission may assist in determining the company's general law and statutory liability for insider trading. The paper argues that it is possible to apply the doctrine of aggregation to combine the act of one servant and the knowledge of another for the purpose of establishing a company's civil liability for insider trading in Australia. It also contends that a company will not lose its memory where it acquires the relevant knowledge through a servant who ceases his or her employment after making relevant business decisions with the knowledge acquired, if the company innocently implemented the decisions after the departure of the servant.

I INTRODUCTION

Insider trading can be defined as 'trading by a trader who possesses information that is "material" to the price of the securities which are traded, which is not already known to other traders in the market, and which is not the product of the analysis of publicly available information by that trader'.¹

Insider trading is typically committed by individuals for the purpose of gaining a profit or avoiding a loss by trading in the securities in questions for themselves. Where human servants of a company engage in insider trading activities in the course of their employment, the problem will arise as to, inter alia, the civil liability of the company. Civil liability of the company will be in issue where insider trading attracts civil penalty and monetary compensation under a given

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¹ Robert Baxt, Ashley Black and Pamela Hanrahan, *Securities and Financial Services Law* (6th ed, 2003) 503 (footnotes omitted). Note though that the prohibited conduct under s 1043A of the *Corporations Act 2001* (Cth) also including procuring (s 1043A (1)(d)), and tipping (s 1043A(2)).

regulatory regime,² or where an action is taken in general law and it is more desirable to sue the company, which normally has a deeper pocket, rather than the servant(s) of the company who actually engaged in the dealing activities.

The relevance of a company's liability for insider trading activities undertaken by its servants is illustrated in a recent regulatory action in Singapore against three employees of the Government of Singapore Investment Commission ('GIC'), which manages Singapore's foreign reserves.³ In this case, three employees of GIC, Lim, Teng, and Choo, learnt about the non-public information that Sumitomo Mitsui Financial Group Inc ('SMFG'), a Japanese firm and one of GIC's portfolio companies, would make a public offering of its convertible preferred stock before the news was announced to the public on 17 February 2003. The three employees sold SMFG shares on the Tokyo Stock Exchange on behalf of GIC on 13 February 2003, avoiding a loss of about S\$710 000 on behalf of GIC. The dealing was detected by Japan's Securities and Exchange Surveillance Commission, who, along with the Financial Services Agency of Japan, alerted the Monetary Authority of Singapore ('MAS'). MAS took a civil penalty enforcement action against the trio, imposing a civil penalty of S\$400 000, S\$240 000 and S\$75 000 against Lim, Teng, and Choo respectively. MAS, however, did not take any action against GIC, as its investigations did not find any breach of *Securities and Futures Act 2002* (Singapore) by GIC as a company. In other words, MAS was satisfied that the three defaulting employees' insider trading liability should not be attributed to GIC. The press release of MAS, however, did not reveal the reasons for this finding.

The GIC's case shows whether or in what circumstances liability for insider trading by company servants can be attributed to the employing company. How insider trading liability is to be attributed to a company in different circumstances, however, remains an unanswered question. This article proposes to make an attempt to answer this question by considering the legal principles governing the ways in which company servants' insider trading civil liability is attributed to the employing companies in Australia.

Australia's inside trading regime contains liability attribution provisions.⁴ However, as the discussion below shows, the operation of the provisions may need the assistance of relevant general law principles. Where an action is taken in general law, the issue of liability attribution will be determined largely by general law liability attribution principles. A review of the development and current state of general law principles of liability attribution is therefore

² Such as under Australia's insider trading regime in pt 7.10 of the *Corporations Act 2001* (Cth).

³ Securities and Exchange Surveillance Commission, *A Civil Penalty Enforcement Action has been Taken by MAS* (2004) Financial Services Agency <<http://www.fsa.go.jp/secc/english/news/others/20041021.htm>> at 20 July 2006; Monetary Authority of Singapore, *MAS Takes Civil Penalty Enforcement Action* (2004)

<http://www.mas.gov.sg/masmcm/bin/pt1MAS_Takes_Civil_Penalty_Enforcement_Action.htm> at 20 July 2006. See also Alexander Loke, 'Corporate Liability for Cross-Border Insider Trading in Singapore' (2005) 17(3) *Australian Journal of Corporate Law* 347, 347-8.

⁴ *Corporations Act 2001* (Cth) s 1042G. See also below Part III B.

imperative for considering a company's liability, both statutory and general law, for insider trading.

The rest of the article will accordingly be organized into three parts. Part II introduces Australia's statutory insider trading regime. Part III looks at the courts' approaches to civil liability attribution in general, whereas Part IV considers how civil liability for insider trading is attributed to a company. For illustrative purposes, most of the insider trading examples will be taken from the context of managed investment.⁵

II AUSTRALIA'S INSIDER TRADING REGIME

Australia's insider trading regime is contained in Part 7.10 of the *Corporations Act 2001* (Cth). The centerpiece of the regime is s 1043A. Under s 1043A (1), a person who is in possession of non-public, price-sensitive information of a 'Division 3 financial product' (the insider)⁶ is prohibited from trading, or procuring another person to trade, in the financial product in question, if the persons knows, or ought reasonably to know, that the information is not generally available and if the information is generally available, a reasonable person would expect it to have a material effect on the price or value of the financial products in question.⁷ Section 1043 A(2) prohibits an insider from communicating inside information about a financial product to another person.⁸

In order not to prevent a person from discharging legal obligations or engaging in otherwise legitimate business activities, ten exceptions are provided, such as an exception for acquisition pursuant to legal requirement,⁹ a Chinese wall exception,¹⁰ and an exception for bodies corporate.¹¹

⁵ A managed investment scheme, according to the *Corporations Act 2001* (Cth) s 9, has three features: (1) people contribute money or money's worth to acquire interests in the scheme; (2) contributions are pooled or used in a common enterprise to produce financial or other benefits for members; and (3) members do not have day to day control over the operation of the scheme. In a layperson's language, most of the managed investment schemes 'involve a number of investors handing over their money or some assets to a professional manager who manages the total fund or collection of assets to produce a return which is shared by investors': Australian Law Reform Commission, *Collective Investments: Other People's Money*, Report No 65 (1993) vol 1, 1. Managed investment is a good context to discuss a company's insider trading liability. As will be seen, insiders of a management/trustee company of a managed investment scheme (eg, an equity fund), have opportunities to trade, with different types of techniques, in not only the securities issued by portfolio entities, but also in securities issued by the management/trustee company itself on inside information.

⁶ *Corporations Act 2001* (Cth) s 1042A: 'Division 3 financial products means: (a) securities; or (b) derivatives; or (c) managed investment products; or (d) superannuation products, other than those prescribed by regulations made for the purposes of this paragraph; or (e) any other financial products that are able to be traded on a financial market.'

⁷ *Corporations Act 2001* (Cth) ss 1043A (1), 1042A.

⁸ *Corporations Act 2001* (Cth) s 1043A(2).

⁹ *Corporations Act 2001* (Cth) ss 1043D, 1043E.

¹⁰ *Corporations Act 2001* (Cth) ss 1043F, 1043G.

¹¹ *Corporations Act 2001* (Cth) s 1043I. Other exceptions include exception for withdrawal from registered (managed investment) scheme (s 1043B); exception for underwriters (s 1043C); exceptions for knowledge of person's own intentions or activities (s 1043H); and exception for officers or agents of body corporate (s 1043J).

Insider trading is a crime under *Corporations Act 2001* (Cth). A contravention of the prohibition under ss 1043A(1) and 1043A(2) attracts a penalty of 2000 penalty units (ie, A\$200 000), or imprisonment for five years, or both.¹² Where the offender is a body corporate, the penalty is a fine of 10 000 penalty units (ie, A\$1 000 000).¹³

A person who has contravened s 1043A(1) or s 1043A(2) can be ordered to pay a pecuniary penalty of up to A\$200 000 to the Commonwealth if certain conditions are met.¹⁴ A person who has contravened s 1043A(1) can also be ordered to compensate the issuer, the buyer, or the seller of relevant financial products who has suffered a loss resulting from such contravention.¹⁵

It is also possible to take a general law action against an insider dealer. The bases of general law actions include breach of contractual, trust, fiduciary duties and duty of confidence.¹⁶

III THE COURTS' APPROACHES TO CIVIL LIABILITY ATTRIBUTION

Broadly, the courts have developed two approaches to the determination of civil liability of a company. The first approach attempts to solve the problem by resorting to the general principles of vicarious liability and agency. The second seeks to answer the question of the company's liability by applying the doctrine variously known as 'organic approach', 'identification', 'alter ego', or 'directing mind and will'.¹⁷ These two approaches are supplemented by a three-step method developed by the Privy Council in a relatively recent case *Meridian Global Funds Management Asia Ltd v Securities Commission* ('*Meridian Global Funds*')¹⁸ which arguably offers an alternative to the organic approach in certain circumstances discussed below.

A Vicarious Liability and Agency

The principles under this approach are well summarised by the authors of *Gower's Principles of Modern Company Law*:

- (i) A principal is bound by the transaction on his behalf of his agents or servants if the latter acted within either
 - (a) the actual scope of the authority conferred upon them by their principal prior to the transaction or by subsequent ratification; or

¹² *Corporations Act 2001* (Cth) sch 3, items 311C, 321A.

¹³ *Corporations Act 2001* (Cth) s 1312; sch 3, items 311C, 321A.

¹⁴ *Corporations Act 2001* (Cth) ss 1317G(1A)(c)(i), 1317G(1A)(c)(ii), 1317G(1A)(c)(iii).

¹⁵ *Corporations Act 2001* (Cth) ss 1043L, 1317HA.

¹⁶ See generally Walter Woon, *Company Law* (2nd ed, 2000) 566; Barry Rider, *Insider Trading* (1983) 67; Brenda Hannigan, *Insider Dealing* (2nd ed, 1994) 128; Barry Rider et al, *Market Abuse and Insider Dealing* (2002) 207.

¹⁷ Ross Grantham, 'Attributing Responsibility to Corporate Entities: A Doctrinal Approach' (2001) 19 *Company and Securities Law Journal* 168, 170.

¹⁸ [1995] 2 AC 500 (Privy Council), on appeal from the Court of Appeal of New Zealand.

(b) the apparent (or ostensible) scope of their authority.

- (ii) A principal, qua employer, may also be vicariously liable in tort for acts of his employees which, though not authorised, are nevertheless within the scope of their employment but, in general, is not criminally liable for their acts.¹⁹

At a general level, the principles of agency hold a principal liable for a transaction entered into on his or her behalf, whereas the doctrine of vicarious liability allocates civil liability for non-transactional contexts, such as torts committed by employees in the course of their employment by the employing company.²⁰

The principles of agency play a significant role in determining a corporation's rights, duties and liabilities. Generally, a company's constitution contains rules of attribution. In *Meridian Global Funds*, Hoffmann LJ regarded these rules as 'primary rules of attribution'.²¹ These primary rules, however, could not be applied without invoking principles of agency:

The company ... builds upon the primary rules of attribution²² by using general rules of attribution which are equally available to natural persons, namely the principles of agency. It will appoint servants and agents whose acts, by the combination of the general principles of agency and the company's primary rules of attribution, count as the acts of the company, and having done so, it will also make itself subject to the general rules by which liability for the acts of others can be attributed to natural persons, such as estoppel or ostensible authority in contract and vicarious liability in tort.²³

There is a historical reason why the agency principles have been applied to attribute rights, duties and liabilities to a company. The early joint stock companies in England from the early 17th Century to early 18th Century were considered partnerships, the relationships of which were regulated by the principles of agency.²⁴ The deed of settlement companies established after the *Bubble Act 1720*, 6 Geo 1, c 18 until the end of the 19th Century were regarded as 'quasi bod[ies] corporate'.²⁵ Company directors were considered agents of their companies.²⁶ That is why '[u]ntil the end of the nineteenth century it seems to have been generally assumed that ... the board of directors was merely an agent of the company'.²⁷

¹⁹ Paul Davies, *Gower's Principles of Modern Company Law* (1997) 201-2 (footnotes omitted).

²⁰ *Ibid* 229.

²¹ [1995] 2 AC 500.

²² By 'primary rules', Hoffmann LJ was referring to the 'rules of attribution' generally found in a company's constitution: [1995] 2 AC 500, 506.

²³ [1995] 2 AC 500, 506 (footnote added).

²⁴ Kam Fan Sim, *The Legal Nature of Unit Trust*, Clarendon (1997) 10.

²⁵ *Re Agriculturist Cattle Insurance Company* (1870) LR 5 Ch 725, 734 (James LJ).

²⁶ James LJ in *ibid*, 734-5 said that:

if he (a shareholder) is liable under any contracts or obligation, or in respect of any act of the body, it is not because they are the contracts, obligations, or acts of his partners or partner, but because they are the contracts, obligations, and the acts of the *quasi* body corporate (under present legislation the actual body corporate), by its properly constituted *agents*. It may be, and generally is, no doubt, that *the agents, the directors*, are shareholders, and in that sense partners, but it is certain that there may be a board of directors perfectly competent to bind the whole body (emphasis added).

²⁷ Davies, above n 19, 183.

However, the courts did not stop applying agency principles to explain the basis of the relationship between companies and their directors even after the *Joint and Stock Companies Act 1844*, 7 & 8 Vict, c 110, which allowed large unincorporated companies to incorporate and achieve separate legal status. In fact, the agency principles are still being applied to attribute the actions, knowledge and intentions of senior officers and directors to the company for many purposes.²⁸

The vicarious liability and agency principles are sufficient and appropriate in many situations where it is necessary to allocate liability to a company for wrongs committed by the company's human servants or agents. However, these principles may not be appropriate when there is a need to determine:

- 1) whether the company itself is at fault for the purpose of determining the company's criminal liability;
- 2) statutory liability which hinges on the company's own blameworthiness; or
- 3) general law civil liabilities in certain circumstances, as will be discussed below.

Also, the agency theory does not solve problems such as whether an employee's knowledge about a fraudulent transaction between the company and a third party, which the employee obtained outside his or her scope of employment, should be imputed to the company where the transaction has been facilitated by the agent. This type of problem was presented in *El Ajou v Dollar Land Holdings plc* ('*El Ajou*'),²⁹ and is further discussed below.

B The 'Organic' Approach

Under the organic theory, the organs of a company, namely the board of directors and the general meeting, when acting within the limits of powers conferred on them by the company's constitution, are regarded not merely as the agents of the company but as the company itself. Under the organic approach, the acts, intention and knowledge of an individual can be regarded as those of the company itself. The individual is the embodiment of the company.

The English courts and courts of English extraction have been reluctant to apply the concept of vicarious liability for the purpose of determining a company's criminal liability. As a result, the organic approach has been the chief means for courts to fix primary liability on companies for criminal wrongs.³⁰

The leading case where the organic theory was originally formulated and applied for the purpose of considering a company's statutory civil liability is *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd*.³¹ In that case, the ship owned by

²⁸ Grantham, above n 17, 169-70.

²⁹ [1994] 2 All ER 685.

³⁰ Harold Ford et al, *Ford's Principles of Corporations Law* (10th ed, 2001) 737; Grantham, above n 17, 171.

³¹ [1915] AC 705.

the appellant and her cargo were lost because the vessel was unseaworthy. The buyer of the cargo sued the appellant. Under s 502 of the *Merchant Shipping Act 1894*, 57 & 58 Vict, c 60, the owner of a ship was not to be liable for the loss or damage happening without his actual fault or if he was not privy to the fault. Mr Lennard had knowledge of the ship's unseaworthiness. He was a director of the appellant company and an active director of another company that managed the ship. He was also the person who was named in the ship's register and was designated as the person to whom the management of the vessel was entrusted. To be entitled to the defence under s 502, it had to be proven that the company itself was not at fault or privy to the fault committed.

The issue in this case was therefore whether the appellant company was at fault for the loss of the ship and her cargo, and that turned on the question of whether Mr Lennard's knowledge of the unseaworthiness of the ship could be regarded as the knowledge of the company. The Privy Council answered this question in the affirmative. Viscount Haldane LJ held that Mr Lennard had failed to provide relevant evidence to displace the presumption that he was the 'life and soul' of the appellant company.³²

In arriving at this conclusion, his Lordship said that for the purpose of s 502 '[i]t is not enough that the fault should be the fault of a servant in order to exonerate the owner, the fault must also be one which is not the fault of the owners, or a fault to which the owner is privy'.³³ Commenting on the way to establish the owner company's blameworthiness, his Lordship said:

corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation ...³⁴

His Lordship continued, 'if Mr Lennard was the directing mind of the company, then his action must ... have been an action which was the action of the company itself'.³⁵

C El Ajou: A More Liberal Organic Approach

In the eyes of a modern lawyer, the original test for the organic approach that Viscount Haldane LC formulated in *Lennard's Carrying* is quite narrow. The person who is to be considered as the embodiment of the company must be the 'directing mind and will', 'the very ego and centre' and the 'life and soul' of the company. In other words, this person must be high up the corporate ladder. This test might have worked well in an age where commercial transactions were less

³² [1915] AC 705, 714. His Lordship, however, did not expressly provide a reason for the existence of the presumption against Mr Lennard.

³³ Ibid.

³⁴ Ibid 713.

³⁵ Ibid.

sophisticated, or where the company in question was relatively small. As commercial transactions have become a great deal more sophisticated and companies have grown in size since the early 20th Century when *Lennard's Carrying* was decided, the limitation of the test formulated by Viscount Haldane LC has become more and more obvious. This is evidenced in two of the cases decided in mid 1990s, which are illustrative of the way in which the courts have developed the organic theory. They are *El Ajou*³⁶ and *Meridian Global Funds*.³⁷

In *El Ajou*, the Court made an attempt to answer the question as to what kind of servants can be the company's directing mind and will. In this case, the defendant Dollar Land Holdings plc ('DLH') received some money for business purposes from some Canadians. The money was the proceeds of a massive fraudulent share selling scheme carried out by the Canadians. The plaintiff's investment manager was bribed to invest the plaintiff's funds, without the plaintiff's authority, in the fraudulent scheme. Having learnt about the truth, the plaintiff brought proceedings against DLH on the ground of, inter alia, knowing receipt.

To succeed on the knowing receipt claim it was necessary for the plaintiff to show that the DLH knowingly received the tainted money. The only employee of DLH who knew about the fraud was one Ferdman, who also facilitated DLH's receipts of the tainted money. Ferdman was a nominee director of DLH who did not carry on the company's business. The main issue was therefore whether Ferdman's knowledge of the fraud could be imputed to the company. If the 'directing mind and will' test was applied with reference to the alleged alter ego's status in the company, Ferdman's knowledge could not be regarded as that of the company. Ferdman was only a nominee director who did not run the company's business. He could not be the 'life and soul' of the company. However, the Court adopted a more flexible approach to deciding whether Ferdman was the 'directing mind and will' of DLH. Lord Nourse held that whether the person held a formal position in the company was not decisive in determining whether that person's mind was the 'directing mind and will'.³⁸ The decisive factor was rather, said his Lordship in adopting Eveleigh LJ's judgment in *R v Andres Weatherfoil Ltd*,³⁹ whether the natural person in question had the status and authority which in law made his or her acts in the matter under consideration the acts of the company.⁴⁰ It was the responsibility of Ferdman, and not anybody else, to arrange the receipt and disbursement of the money received, which represented the money fraudulently misapplied. The directing mind and will in relation to the transactions regarding the receipt of the tainted assets was therefore that of Ferdman, rather than those who were responsible for business decisions generally.⁴¹ This case therefore established that the 'directing mind and will'

³⁶ [1994] 2 All ER 685.

³⁷ [1995] 2 AC 500.

³⁸ [1994] 2 All ER 685, 696.

³⁹ [1972] 1 All ER 65, 70.

⁴⁰ [1994] 2 All ER 685, 696.

⁴¹ *Ibid* 696-7.

could be that of different persons in respect of different activities, not necessarily that of the persons who had general management or control of the company.

D Meridian Global Funds: No Need to Find the Directing Mind and Will?

If the court in *El Ajou* managed to expand the meaning of 'directing mind and will', what the Privy Council did in *Meridian Global Funds* was to declare that it may not be necessary to look for the 'directing mind and will' for the purpose of liability attribution. In that case, a group of people tried to take a 49 per cent control of a cash-rich publicly listed company in New Zealand, Euro-National Corporation Ltd ('ENC'). Koo, the Chief Investment Manager of the appellant company and Ng, a senior portfolio manager of the same company, were both members of this scheme. The raiders intended to finance the takeover out of ENC's own assets. Koo and Ng misappropriated the appellant company's funds and applied them as the bridging finance.⁴² Koo was in a position to make investment decisions without the supervision of the Board.

The raiders' manoeuvre made the appellant company a 'substantial shareholder' in ENC for about 30 days, for the purpose of s 20 of the *Securities Amendment Act 1988* (NZ). This provision requires a person to notify the issuer and the stock exchange as soon as the person knows or ought to know that the person is a substantial security holder in the public issuer. The question for decision in this case was, therefore, whether the appellant company knew or ought to have known that it was a substantial shareholder of ENC as soon as Koo and Ng acquired the shareholdings in ENC with its funds. To answer this question it was necessary to consider whether Koo's knowledge about the shareholding could be imputed to the company, as the board was not aware of the acquisition of the ENC shares.

The Court answered the question in the affirmative. The Court's decision was based on a three-step liability attribution approach it formulated in the judgment of this case. This approach involves a consideration of three sets of rules: the primary rules, the general rules and the special rules. The primary rules are normally found in a company's constitution. Rules which say 'for the purpose of appointing members of the board, a majority vote of the shareholders shall be a decision of the company' or 'the decisions of the board in managing the

⁴² The raiders' plan to takeover ENC by using ENC's own funds was to be achieved through effecting some shortselling transactions of a small number of Malaysian and Indonesian shares between the appellant company and ENC through a stockbroker, who was also a member of the scheme. The funds from the appellant company were to be notionally paid to ENC 20 days before they were to be paid back to the appellant company by ENC, plus some profit. Prior to ENC's notional purchase back from the appellant company, the stockbroker was to use the appellant's funds to purchase a large chunk of shares from ENC to gain control of this company. The stockbroker was then to have ENC make payment to the appellant company in relation to the purchase of the Malaysian and Indonesian shares from the appellant company. However, bridging finance was needed to cover the gap between buying the shares and gaining control of the company's money. All went as planned until the independent directors frustrated the raiders' plan to make ENC pay for the purchase from the appellant company by imposing conditions not acceptable to the raiders. For a more detailed description of the scheme, see *Meridian Global Funds Management Asia Ltd v Securities Commission* [1994] 2 NZLR 291, 297.

company's business shall be the decisions of the company'⁴³ are examples. Primary rules can also be implied by company law, for example, the rule that the unanimous decision of shareholders is the decision of the company.⁴⁴ The general rules are principles of agency. A problem of liability attribution can generally be solved by the application of the general principles of agency in conjunction with a company's primary rules.⁴⁵

Where primary rules and general rules do not provide an answer to the question (for example, where rules are 'stated in language primarily applicable to a natural person and require some act or state of mind on the part of that person "himself" or "herself", as opposed to his or her servants and agents'), a set of 'special rules' should be applied.⁴⁶ The so-called 'special rules' resemble the organic approach in one way, meaning that one person's knowledge or act will be taken as that of the company. The difference between the organic approach and the special rules is that the latter are not based on Viscount Haldane LC's 'directing mind and will' test. The Court said that it

must fashion a special rule of attribution for the particular substantive rule. This is always a matter of interpretation: given that it was intended to apply to a company, how was it intended to apply? Whose act (or knowledge, or state of mind) was *for this purpose* intended to count as the act etc. of the company? One finds the answer to this question by applying the usual canons of interpretation, taking into account the language of the rule (if it is a statute) and its content and policy.⁴⁷

Applying the special rule, the Court ruled that the policy behind the section was to compel prompt disclosure, and, for the purpose of achieving this policy objective, the company acquired the knowledge about its shareholding when this was known to Mr Koo, who had authority to do the deal.⁴

As seen from the above discussion, the Privy Council did not resort to Viscount Haldane LC's 'metaphysics of companies' for its formulation of the special rule. In fact, the Court said that it was not necessary to look for an overall 'directing mind and will'.⁴⁹ What should be done was to consider the purpose for a liability attribution in a given situation by looking at the language and objective of the substantive rule (which was s 20 of the *Securities Amendment Act 1988* (NZ) in *Meridian Global Funds*).

Given the size of modern companies and financial conglomerates, and the complexities of modern commercial transactions, it will be increasingly difficult to pinpoint a single individual as the alter ego of a company. The significance of

⁴³ [1995] 2 AC 500, 506.

⁴⁴ *Ibid.*

⁴⁵ *Ibid.* 507.

⁴⁶ *Ibid.*

⁴⁷ *Ibid.*

⁴⁸ *Ibid.* 511.

⁴⁹ *Ibid.* 'It was ... not necessary in this case to inquire into whether Koo could have been described in some more general sense as the "directing mind and will" of the company': at 511.

the *Meridian Global Funds* lies in the Privy Council's interpretation of the organic approach, which provides an answer to the question of how to determine a company's civil liability in the modern age, where general rules and the organic approach do not solve the problem. *Meridian Global Funds* has since been applied in Australia in determining whether a company was in possession of necessary knowledge to incur civil liability.⁵⁰

It should, however, be noted that Hoffman LJ's judgment in *Meridian Global Funds* did not kill the organic approach, nor did it render the organic approach moribund, as Sullivan suggests.⁵¹ All it did was to provide a framework for analysis 'and dispels the notion that, for all offences, the person with whom a corporation is identified must be its directing mind and will'.⁵² For example, the identification rule (ie, the organic approach), as Rose LJ held in *Attorney General's Reference (No 2 of 1999)*,⁵³ 'remains the only basis in common law for corporate liability for gross negligence manslaughter',⁵⁴ although it will have no application when construing statutes.⁵⁵

IV ATTRIBUTION OF CIVIL LIABILITY FOR INSIDE TRADING TO A COMPANY

To discuss liability attribution for insider trading to a company, four issues need to be considered. First, which approach should be adopted when the company's general law liability is at issue. Second, how statutory civil liability for insider trading is attributed to a company. Third, whether it is possible to combine the knowledge of one natural person and the act of another person to hold the employer company liable. Finally, whether a company 'loses its memory' where the person whose knowledge can be attributed to the company has made a decision to trade on inside information for the company and then the company does the actual trading innocently, after this person's departure.

A Liability Attribution to a Company: Which Approach is Preferred?

When facing an issue on the attribution to a company of general law civil liability for insider trading, an unavoidable question a court must answer is which

⁵⁰ In *Commercial Union Assurance Company of Australia Ltd v Beard* (1999) 47 NSWLR 735, *Meridian Global Funds* was applied in determining whether an insurance company had the knowledge of a material fact relating to the identity of a shareholder of the insured company in order to determine whether the insured had a duty of disclosure. In *Perth City v L* (1996) 90 LGERA 178, *Meridian Global Funds* was followed in determining whether a City Councilor's state of mind was attributable to the City Council.

⁵¹ Sullivan calls the identification doctrine 'a doctrine that may be on the point of disintegration': G R Sullivan, 'The Attribution of Culpability to Limited Companies' (1996) 55 *Cambridge Law Journal* 515, 539.

⁵² *DPP (Vic) Reference No 1 of 1996* [1998] 3 VR 352, 355 (Callaway JA).

⁵³ [2000] QB 796.

⁵⁴ *Ibid* 816.

⁵⁵ *Ibid* 814-16.

approach it should adopt in accomplishing the task. In other words, where the primary rules do not help, should the court apply the general rules or special rules essayed by *Meridian Global Funds*?

1 General Rules

The rules of general application are only helpful where the person the attribution of whose liability is at issue (the defaulting person) was acting as the company's agent in a legal sense,⁵⁶ or where this person's trading activities, which were carried out in the course of his or her employment, was tortious. Rules of agency may be applied where, for example, the defaulting person is the company's broker in relation to the relevant financial product transaction.

The courts, however, will not impute the knowledge possessed by an agent to the company in all circumstances. In *El Ajou*, Hoffmann LJ summarized the situations where the rules of agency, under which the knowledge of an agent was imputed to the principal, are applicable, into three categories. The first was where the agent's knowledge affects the performance or terms of the authorized contract; the second, where the principal itself has a duty to investigate or to make disclosure; and the last where the agent is authorized to receive communication.⁵⁷

The second and third categories can be relevant to an insider dealing scenario. It might be helpful to illustrate this by some examples in the managed investment context. In Australia, a registered managed investment scheme must be managed by an entity called 'responsible entity' ('RE'), which must be a public company. The RE must hold the scheme assets on trust.⁵⁸ Where a registered scheme is structured as a unit trust fund, the RE is both the fund manager and the corporate trustee of the fund. When the RE affects transactions of financial products between itself and a scheme investor, it, as the scheme trustee, will have a duty to disclose to the investor its personal interest in the transactions. That is because a trustee will need to obtain an informed consent from its beneficiaries when he or she makes profits from his or her office.⁵⁹ This is precisely a situation where the principal has a duty to make disclosure. In this kind of situation, the knowledge of the person who has effected the transaction on behalf of the RE on inside information will be at issue when considering the RE's insider trading liability.

One situation where the third category is relevant is where information about an investee entity is given to an employee of the RE. Because a fund may invest in one or more entities, those entities may wish to give business briefings to their investors.⁶⁰ The information obtained or gauged from the briefings may be used in the formulation of investment strategy. The person authorised to attend the

⁵⁶ *El Ajou v Dollar Holdings plc* [1994] 2 All ER 685, 698 (Nourse LJ).

⁵⁷ *Ibid* 702-3.

⁵⁸ *Corporations Act 2001* (Cth) ss 601FA, 601FB, 601FC(2).

⁵⁹ *Bray v Ford* [1896] AC 44. Note however, the RE is exempted from this duty if a transaction is effected because of a unitholder's request for redemption (withdrawal from the scheme): *Corporations Act 2001* (Cth) s 1043B.

briefings or equivalent activities will be the person authorised to receive communication under Lord Hoffmann's third category.

The extent to which Lord Hoffmann's summary on the circumstances in which rules of agency may be useful for knowledge attribution purposes is, however, questionable. It is doubtful whether a company, including a trustee company, would engage an agent to discharge its duties of disclosure or to receive information on its behalf.

The nature of insider trading liability in general law is determined, to a large extent, by the nature of the relationship between the parties. Insider trading can thus amount to, depending on the nature of the relationship between the parties to the transaction in question, a breach of trust, a breach of fiduciary obligations, a breach of confidence, and conceivably, a breach of contract.⁶¹ The only situation where insider trading activities may amount to a tort seems to be where a person who is in possession of inside information has tipped another person (the tippee) for the purpose of injuring another person's financial interests. In this kind of situation, both the tipper and the tippee may be liable for civil conspiracy.⁶² Where an employee of the company in question is involved in this kind of civil conspiracy in the course of his or her employment, rules of vicarious liability may be applied to consider the liability of the company in question.

2 The *El Ajou* Version of Organic Rule or Meridian Global Funds Special Rules

Where rules of general application are inapplicable, it will be necessary to consider whether and how *El Ajou* version of organic rule or the special rules that the Privy Council essayed in *Meridian Global Funds* should be applied. In essence, there is not much difference between these two approaches. If *El Ajou* is applied, the problem to be decided is whether the directing mind and will of the company in relation to the impugned insider trading transaction is that of the defaulting servant(s). If Lord Hoffmann's 'special rules' are applied, the issue would be whose act (or knowledge, or state of mind) was for the purpose for which the transaction was effected intended to count as the act, etc, of the company.

Lord Hoffmann did not make reference to *El Ajou* in the judgment that His Lordship delivered on behalf of the Privy Council in *Meridian Global Funds*. Given that the former case is a Court of Appeal case whereas the latter is a subsequent Privy Council case, the failure of the Privy Council to evaluate *El*

⁶⁰ Investment Company Institute, *The Money Managers: Professional Investment Through Mutual Funds* (1967) 79; Francesco Guerrero and Ben Hunt, 'FSA Grapples with Selective Disclosure: Baltimore Technologies' Latest Briefing has Given Fresh Impetus to Regulators' *Financial Times* (London) 27 March 2001, 26; Australian Securities and Investment Commission, 'ASIC Cracks Down on Continuous Disclosure' (Press Release, 13 August 2001), <http://www.asic.gov.au/asic/asic_pub.nsf/byheadline/01%2F284+ASIC+cracks+down+on+continuous+disclosure?opendocument> at 22 June 2006.

⁶¹ Woon, above n 16, 570-1; Hannigan, above n 16, 128-52.

⁶² Woon, above n 16, 571.

Ajou in Meridian Global Funds means the status of the former case is uncertain and the courts are more likely to prefer the 'special rules' developed by the Privy Council.

As pointed out above, where the liability in question is stated in language primarily applicable to a natural person and requires some act or state of mind on the part of that person 'himself' or 'herself', as opposed to his or her servants or agents, rules of agency are not helpful. This type of liability is often statutorily imposed.⁶³ This, however, does not necessarily mean that in general law a company's civil liability never requires the act or state of mind of the company itself. A relevant example is the civil liability of a corporate trustee qua corporate trustee. The act or state of mind of a company that also acts as a trustee is not necessarily that of the corporate trustee itself. The corporate trustee, when acting as the trustee, can incur civil liability if it acts in breach of the fiduciary obligations imposed on it by the law. The liability here is the personal liability of the trustee itself.

Moreover, the consequence for a breach of trust is often more serious than that for breaching other kinds of civil obligations. For example, restitutionary remedies such as account of profits will be available to beneficiaries where a trustee has made profits through a breach of trust, regardless of whether the beneficiaries have suffered any actual loss in a practical sense. In contrast, damages for breach of contract, or tortious duties, will not be awarded if the claimant has suffered no loss (for example, loss of bargain for breach of contract). It can therefore be argued that the court may be more reluctant to attribute to the corporate trustee the act and the state of mind of its servants than it would be to do so to an ordinary company. It follows that the agency/vicarious liability approach or the so-called 'primary rules' or 'general rules' may be inapplicable where the issue is the attribution of liability to a corporate trustee acting as a trustee.

There are situations where a company engages in insider trading in its capacity as a corporate trustee. One possible scenario is where a management company (which is an RE) trades in the financial products issued by an investee entity on inside information. In a situation where it is necessary to determine whether the defaulting servant(s)' insider trading liability is to be regarded as that of the RE, if the primary rules or rules of general application do not assist, the *Meridian Global Funds* special rules may be applied to solve the problem.

B Attribution of Statutory Civil Liability for Insider Trading

For the purpose of Part 7.10, Division 3 of the *Corporations Act 2001* (Cth), a body corporate is taken to possess any information which an officer of the body corporate possesses and which came into his or her possession in the course of the performance of duties as such an officer.⁶⁴ Also, if an officer of a body

⁶³ See above n 31 and accompanying text.

⁶⁴ *Corporations Act 2001* (Cth) s 1042G(1)(a).

corporate knows any matter or thing because he or she is an officer of the body corporate, it is to be presumed that the body corporate knows that matter or thing.⁶⁵ Section 9 defines ‘officer’ as, inter alia, a director (including a ‘shadow director’), or secretary of the corporation, or a person who has the capacity to affect significantly the corporation’s financial standing.

Section 1042G (1)(a) seems to amount to a straightforward liability attribution. The information an officer possesses is taken to be in the possession of the company. The relevant act or the state of mind of the officer is regarded as that of the employing company, depending on whether ‘possession’ means the physical element or mental element.

On the other hand, the rule under s 1042G(1)(b) falls short of direct liability attribution. An officer’s knowledge is presumed to be that of the employing company but such presumption is rebuttable. In other words, if the company has managed to rebut the presumption, the officer’s knowledge will not be attributed to it.⁶⁶ However, a rebuttal of the presumption necessarily involves a decision on whether the company itself has the knowledge.

In making a determination on whether the company itself has the knowledge, the court will most likely resort to the ‘special rules’, if the ‘primary rules’ in the company’s constitution do not answer the question. One of the reasons is that the liability in s 1043A is statutorily imposed in language primarily applicable to a natural person.⁶⁷ A further and stronger reason, discussed above,⁶⁸ is that general rules (rules of agency and vicarious liability) will only be relevant where the officer whose attributability of knowledge is at issue can be regarded as an agent of the company in a legal sense, or the insider trading liability of this person can be regarded as a tortious liability. Where the officer in question cannot for a relevant purpose be regarded as the company’s agent, rules of agency will offer little assistance. Statutory insider trading liability is not tortious, and rules of vicarious liability will likewise be of little help.

Sections 1042G(1)(a) and 1042G(1)(b) alone may not always solve the problem of civil liability attribution. For the purpose of establishing a company’s civil liability for insider trading under s 1043L, the alleged insider trader must have contravened subsection 1043A(1).⁶⁹ To prove a contravention of s 1043A(1), three elements must be established. First, the alleged insider trader must be in possession of the non-public material information regarding a given financial product.⁷⁰ Second, the person must know, or ought reasonably to know,⁷¹ or be reckless as to,⁷² the general availability and the materiality of the information.

⁶⁵ *Corporations Act 2001* (Cth) s 1024G(1)(b).

⁶⁶ See especially Gregory Lyon and Jean Jacques Du Plessis, *The Law of Insider Trading in Australia* (2005) 22.

⁶⁷ The word ‘person’ is used in s 1043A.

⁶⁸ See above n 56 and accompanying text.

⁶⁹ *Corporations Act 2001* (Cth) s 1043L(1).

⁷⁰ *Corporations Act 2001* (Cth) ss 1043A(1)(a), 1043L(1)(a).

⁷¹ *Corporations Act 2001* (Cth) s 1043A(1)(b).

⁷² *Corporations Act 2001* (Cth) s 1043L(1)(b).

Third, the person must have engaged in a prohibited conduct prescribed under ss 1043A(1)(c) (trading) and 1043A(1)(d) (procuring another person to trade). Sections 1042G(1)(a) and 1042G(1)(b) can, at best, solve the liability attribution problem associated with the first two elements only. Section 1043A does not contain any provision on how to attribute a natural person's liability for contravening ss 1043A(1)(c) (ie, to apply for, acquire, or dispose of Division 3 financial products while in possession of inside information) and 1043A(1)(d).⁷³

Section 769B (1) provides that conduct engaged in on behalf of a body corporate:

- (a) by a director, employee or agent of the body, within the scope of the person's actual or apparent authority; or
- (b) by any other person at the direction or with the consent or agreement (whether express or implied) of a director, employee or agent of the body, where the giving of the direction, consent or agreement is within the scope of the actual or apparent authority of the director, employee or agent;

is taken, for the purpose of a provision of Chapter 7 or a proceeding under Chapter 7, to have been engaged in also by the body corporate.

Section 769B(1), though, may not be useful for attributing liability under ss 1043A(1)(c) and 1043A(1)(d). A funds management company, for example, may authorise certain employees or agents to engage in the conduct described in s 1043A(1)(c) (ie, to apply for, acquire, or dispose of division 3 financial products while in possession of inside information), or enter into an agreement to apply for, acquire, or dispose of relevant division 3 financial products. In the meantime, it may be outside the scope of the authority of a servant or agent to trade, or to enter into an agreement to trade, in division 3 financial products in certain circumstances. One such circumstance is when the person authorised is in possession of price-sensitive information about the financial products in question. Consider the example of 'front-running'. Front-running occurs 'when a broker/dealer, knowing a client has a large or market-sensitive order, puts through a transaction on her or another client's behalf, thus benefiting from the pre-warning'.⁷⁴ Front-running is a form of insider trading; that a large order has been placed is non-public information, and that the placement of the order will push up or lower down the price of the security means that it is material information.

In a funds management setting, an investment manager will normally be authorised to make investment decisions for a managed investment scheme. The manager may also be authorised to make investment decisions for the funds management company's house account. However, a decision to trade on behalf of the house account before effecting a large transaction of the same financial product on behalf of the scheme is most likely to be outside the scope of authority given to the investment manager.

⁷³ The exceptions listed under ss 1043B-1043K do not contain rules of attribution.

⁷⁴ Australian Stock Exchange Limited, 'Circular to Member Organizations' (21 June 1990).

Another example is ‘scalping’. Scalping refers to the practice of trading securities prior to the release of a research report and while in possession of the recommendation contained in the research report.⁷⁵ It is generally agreed that recommendations of an advisory service with a large circulation could have at least a short-term effect on a stock’s market price.⁷⁶ Evidence of scalping has been found among investment professionals.⁷⁷ Scalping is a form of insider trading in that the person engaged in the practice trades prior to the release of price-sensitive information relating to the financial products traded.

An investment manager may have the authority to access investment recommendations contained in research reports prior to their release but he or she may not have the authority to trade for a scheme that the funds management/trustee company (the responsible entity) administers, or for the RE’s own house account, prior to the release of the reports.

Where s 769 B(1) does not help, resort can be made to general law rules to solve the problem. Applying the rules formulated by Hoffmann LJ in *Meridian Global Funds*, what one needs to do is to look at the constitution of the company that acts as the scheme manager/trustee and see if it contains rules on the persons who are authorised to act for the company in a given situation. If the relevant provisions of the constitution, if any, do not answer the question, then resort should be had to the so-called ‘special rules’, rather than ‘general rules’. General rules are not appropriate here, given that s 1043A is couched in language primarily applicable to a natural person and presumably requires some act or state of mind on the part of that person ‘himself’ or ‘herself’, as opposed to that of her servants or agents. The straightforward organic approach (the identification rules) is not applicable either, because that approach has no application when construing the statutes.⁷⁸

In applying ‘special rules’, consideration should be given to the context in which insider trading was committed. For example, where the conduct in question is trading or procuring, the act of the person who has the authority to make investment decisions or to engage in activities that may amount to procuring may be regarded as the act of the RE.⁷⁹

⁷⁵ Ibid.

⁷⁶ Tamar Frankel, ‘The Regulation of Money Managers: The Investment Company Act and the Investment Advisers Act’ (1980) vol 2, 387.

⁷⁷ United States Securities and Exchange Commission, *Report of the Special Study of Securities Markets*, HR Doc No 95, 88th Cong, 1st sess, pt 1, 372 (1963); cited in *ibid*.

⁷⁸ *Attorney General’s Reference (No 2 of 1999)* [2000] QB 796, 813-16 (Rose LJ).

⁷⁹ In *Meridian Global Funds*, the knowledge of the chief investment officer of the fund management company was regarded as the knowledge of the company for the purpose of s 20 of the New Zealand *Securities Amendment Act 1988* (NZ), which requires, inter alia, the holder of 5 per cent or more of shares of a listed company to disclose information regarding his or her shareholding (*Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500, 511). Likewise, where criminal liability for tipping is at issue (no civil compensation is available in Australia for tipping: *Corporations Act 2001* (Cth) s 1043L(1)(c)), the act of the officer who is authorized by the company to communicate with the person who turns out to be the tippee is likely to be seen as the act of the company itself.

C The Doctrine of Aggregation

Where all the three elements (possession of information, knowledge of availability and materiality of information, and trading or procuring) can be found in the same natural person employed by a company, it may not be too difficult to attribute that person's contravention and the consequent liabilities to the company. However, it would be hard to establish liability for contravening s 1043A(1) (which prohibits insiders from dealing and procuring), or the company's insider dealing liability in general law, if one servant had the possession and knowledge and another who did not possess the information and knowledge performed the prohibited act, unless the so called 'doctrine of aggregation' is applied.

Under the doctrine of aggregation, 'knowledge attributed to the company in one way is combined with an act attributed to it in another, so as to make the company liable in circumstances in which neither of the individuals is liable'.⁸⁰ Aggregation has been rejected in the criminal law in the United Kingdom.⁸¹ In Australia, however, criminal negligence of a corporation under the *Criminal Code Act 1995* (Cth) can be established by aggregating the conduct of any number of its employees, agents or officers.⁸²

The doctrine of aggregation, however, is not ruled out in civil law cases in Australia, at least where a company's liability is in issue, although Davis, the author of *Gower's Principles of Modern Company Law*, is of the view that it is ruled out in civil law cases based on common law fraud in the United Kingdom.⁸³ The conclusion of the learned author of *Gower* is based on the fact that the application of the doctrine was disallowed in *Armstrong v Strain*,⁸⁴ a United Kingdom civil case based on common law fraud.⁸⁵

In *Armstrong v Strain*, the Court refused to combine the innocent misrepresentation made by an agent and the principal's knowledge as to the true state of affairs to make the principal guilty of fraud. The basis of the decision was that neither the agent nor the principal was fraudulent.⁸⁶ One cannot add one innocent state of mind to another innocent state of mind to find a dishonest state of mind.⁸⁷

Armstrong v Strain, however, is not an authority denying the operation of the

⁸⁰ Davies, above n 19, 231.

⁸¹ *Ibid.* In *R v HM Coroner for East Kent ex parte Spooner* (1989) 88 Cr App R 10 ('*Ex parte Spooner*'), Bingham LJ held at 16-17, for the purposes of convicting a company for manslaughter, the *mens rea* and *actus reus* of the manslaughter must be found against an individual who is identified as the embodiment of the company. Lord Rose cited with approval Bingham LJ's observation in *Ex parte Spooner* in *Re Attorney General's Reference (No. 2 of 1999)* [2000] QB 796, 813-14.

⁸² *Criminal Code Act 1995* (Cth) s 12.4(2).

⁸³ Davis, above n 19, 231.

⁸⁴ [1952] 1 KB 232 (Court of Appeal).

⁸⁵ Davis, above n 19, 231; above n 46.

⁸⁶ [1952] 1 KB 232, 247-8 (Romer LJ).

⁸⁷ [1952] 1 KB 232, 246 (Birkett LJ), citing the trial judge Devlin J with approval.

doctrine of aggregation for the purpose of establishing the fraud of a company, where one of the agents or servants possesses the knowledge for establishing a fraud, and another agent or servant does the act, if the agents or servants are identified as the embodiment of the company. Indeed, in *Krakowski v Eurolynx Properties Ltd*,⁸⁸ the Australian High Court held a company liable for fraudulent misrepresentation through aggregating the representation made on its behalf by a selling agent and a conveyancing agent (a solicitor of the company), and the knowledge possessed by one or more company officers of facts that rendered the representation false.⁸⁹

The doctrine of aggregation was in fact applied in some earlier Australian cases where common law fraud was not in issue. For example, the Court in *Brambles Holdings Ltd v Carey*⁹⁰ was willing to combine the knowledge of different company officers to hold that the company did not act under ‘an honest and reasonable mistake of fact’ as a defence for a regulatory offence. In *Re Chisum Services Pty Ltd and the Companies Act 1961*,⁹¹ the Court applied the aggregation doctrine to hold that an advancement was void as against a liquidator⁹² where a bank had knowingly accepted advancement from an insolvent company made for the purpose of extinguishing the company’s indebtedness to the bank.⁹³

The doctrine of aggregation is not ruled out in civil cases not based on common law fraud, even in the United Kingdom.⁹⁴ For example, the doctrine was implicitly invoked in *WB Anderson & Sons Ltd v Rhodes (Liverpool) Ltd*⁹⁵ to hold a corporation liable for negligence. The Court combined innocent misrepresentations made by a manager of the corporation with the negligent omission of two other employees to render the manager’s communications misrepresentations.⁹⁶

Given that the doctrine of aggregation can be invoked in Australia in criminal negligence and civil cases, whether or not fraud is involved, and that insider trading does not normally even involve fraud or deception, it is not technically

⁸⁸ (1995) 183 CLR 563.

⁸⁹ The misrepresentation was made through a failure to disclose a material fact (the existence of a collateral contract that would dilute the interest of the plaintiff under the head contract). The defendant company’s selling agent (C), who made the misrepresentation, and an officer of the defendant company (R) were both aware of a term (as to the future investment return of the property) demanded by the plaintiff. Another company officer (G) and the conveyancing solicitor were both aware of the collateral contract entered into by the defendant with the prospective tenant, which was to reduce the plaintiff’s expected return under the head contract. The defendant company did not call the selling agent (C) and its officer (R) to give evidence in the proceedings. It was not therefore sure whether C and R were aware of the existence of the collateral contract. It is arguable that the court not only aggregated the misrepresentation made by its agents and the knowledge of its officer G but also aggregate the knowledge C and R regarding the term that the plaintiff demanded as to the prospective return of the property and G’s knowledge re the existence of the collateral contract.

⁹⁰ *Brambles Holdings Ltd v Carey* (1976) 15 SASR 279.

⁹¹ (1982) 7 ACLR 641.

⁹² *Ibid.*

⁹³ *Ibid.*

⁹⁴ Davis, above n 19, 231.

⁹⁵ [1967] 2 All ER 850.

⁹⁶ *Ibid* 857 (Cairns J).

impossible to hold a company civilly liable for insider dealing where one of its servants had the possession of and knowledge about non-public material information while another engaged in a prohibited act, if both the act and the knowledge can be attributed to the company.⁹⁷

D Can a Company Lose its Memory?

There is a further question that needs to be considered in relation to attributing the knowledge a servant of the company possesses to the company; that is, whether the company can lose its memory when the servant dies or departs. A hypothetical scenario illustrates the relevance of this issue. Say, for instance, the chief investment manager of a funds management company that manages an unlisted property trust learns from the results of the most recent valuation of a certain class of the underlying assets of the scheme that the price of the relevant units will increase when the valuation results are announced one week later. He/she immediately makes a decision to purchase 100 000 units for the responsible entity's own account in two days' time and sell them after the valuation results are announced to the public. The manager leaves the company the next day. The transactions are completed after the manager's departure by his or her colleagues who do not possess the non-public material information and the knowledge as to the information's materiality. If the chief investment manager's knowledge regarding the valuation results can be attributed to the management company, and if the company is regarded as having lost its memory when the chief investment manager departed, the company will not be held liable for insider trading.

In *El Ajou*, the trial judge held that 'the company should not be treated as continuing to possess that knowledge after the director in question has died or left its service. In such circumstances, the company can properly be said to have "lost its memory"'.⁹⁸ In the Court of Appeal, both Nourse LJ and Hoffmann LJ disagreed with this view. Lord Nourse held that if the director in question had acquired knowledge, and then genuinely forgotten about the relevant knowledge by the time the relevant conduct of the company occurred, the director's knowledge could not be attributed to the company. His Lordship held, however, that where the relevant steps were taken prior to the departure of the director, it was unrealistic to hold that the company ceased to have the knowledge just because the mind and will that had been the source of the company's action had played no role in the action after his or her departure.⁹⁹

Lord Hoffmann agreed with Nourse LJ on this point. His Lordship held that once knowledge was treated as being the knowledge of the company in relation to a given transaction, the company continued to be affected by that knowledge for any subsequent stages of the same transaction.¹⁰⁰ Lord Hoffmann's judgment on

⁹⁷ Davis, above n 19, 321. The fear of the operation of the doctrine of aggregation led the United Kingdom legislature to confine the offence of insider trading to individuals.

⁹⁸ *El Ajou v Dollar Holdings plc* [1994] 2 All ER 685, 697.

⁹⁹ *El Ajou v Dollar Holdings plc* [1994] 2 All ER 685, 697.

¹⁰⁰ *Ibid* 706.

this issued was cited with approval by the New South Wales Court of Appeal in *Tszyu v Fightvision Pty Ltd* ('*Tszyu*').¹⁰¹ The position taken by United Kingdom Court of Appeal's judgment in *El Ajou*, which was adopted by the New South Wales Court of Appeal in *Tszyu*, means that where the person whose knowledge is attributable to the company acquires the relevant knowledge and makes the decision to trade on the inside information he or she has obtained on behalf of the company prior to her departure, the company will not be regarded as having lost its memory when it innocently proceeds to implement the insider trading decision made by the person who has left its service.

V CONCLUDING REMARKS

Traditionally, two methods have been applied to attribute liability to a company. The first uses the general principles of vicarious liability and agency. The second is the organic theory. The UK courts and courts of English extraction are reluctant to apply the vicarious liability and agency principles in criminal cases. The organic theory is normally applied in criminal cases and civil cases where the statutory liability of a company in question cannot be proven unless personal fault of the company is shown. A number of cases since the mid 1990s have demonstrated the inadequacy of the orthodox approaches to corporate liability. The ways in which the courts solved the problems are best illustrated in *El Ajou* and *Meridian Global Funds*. In *El Ajou*, a liberal version of organic theory was applied to determine a company's liability for the breach of fiduciary obligations, as distinct from statutory civil obligations. In *Meridian Global Funds*, the Privy Council held that it is not necessary to look for the 'directing mind and will' when determining whose act or omission or mental state is to be regarded as that of a company.

The three-tier tests the Privy Council formulated in *Meridian Global Funds* have helped rationalize the courts' approach to determining a company's civil liability. Where an action is taken in general law, attribution of liability should be possible by applying the *Meridian Global Funds* approach. In fact, what can be achieved through applying the special rules expounded in *Meridian Global Funds* can also be achieved by applying the more liberal version of the organic approach developed in *El Ajou*. The problem with *El Ajou* is that its status is uncertain, as a result of the failure of the Privy Council in *Meridian Global Funds* to evaluate the Court of Appeal's decision in *El Ajou*.

The failure of the Privy Council in *Meridian Global Funds* to evaluate *El Ajou* also leaves doubts as to the status of Hoffmann LJ's decision in that case on the applicability of the agency theory. Lord Hoffmann's decision on the range of operation of the agency theory is important for the purpose of determining a company's insider trading liability. The value of Hoffmann LJ's decision on this issue, if it stands, helps determine in what circumstances the agency theory or in

¹⁰¹ (1999) 47 NSWLR 473, 527.

other words, the 'general rules' referred to in *Meridian Global Funds*, may be applied in determining the liability of a company for its servant(s)' insider trading activities. For example, according to Hoffmann LJ, the agency theory can be applied where the company in question has a duty to make disclosure. As it is mentioned above, making profits through effecting transactions of scheme interests with scheme members without informed consent is precisely a situation where the funds management/trustee company has a duty to disclose its interest in the prospective transaction.

Liability attribution is relatively straightforward when an action is taken under the *Corporations Act 2001* (Cth). Under s 1042G(1)(a), the information an officer possesses is taken to be in the possession of the company. However, under s 1042G(1)(b), an officer's knowledge acquired through his or her office is presumed to be that of the company. Of course, the officer's knowledge will not be treated as that of the company if the company manages to rebut the presumption. The displacement of this presumption may need the assistance of the general law rules on liability attribution, as the task will involve a determination on the question of whether the company does have the knowledge.

There are two reasons why the 'general rules' referred to in *Meridian Global Funds* may not offer much help in an effort to displace the s 1042G(2) presumption. The first lies in the need for proving that the alleged insider, the company *itself*, has the knowledge regarding the general availability and materiality of the information regarding the financial product it has allegedly dealt on through a servant.¹⁰² The second is that the utility of rules of general application is limited to situations where the person the attribution of whose liability is at issue acts as the company's agent for the relevant purpose in a legal sense or where the insider trading liability at issue is tortious. The traditional 'organic' approach may not be appropriate either. The traditional organic approach, as discussed above, is inappropriate for attributing liabilities to large, modern companies where sophisticated transactions are effected.¹⁰³ Both the more liberal version of organic theory that the Court of Appeal developed in *El Ajou* and the *Meridian Global Funds* 'special rules' should be able to accomplish this task. Nevertheless, for the reason stated above, it is better to try to displace the s 1042G(1)(b) presumption through the latter approach.

Where one servant of a company has possession of inside information and another does an act that would render the company liable for insider dealing if the act was done by the first mentioned person, it is possible to establish the company's civil liability by applying the doctrine of aggregation. While the doctrine is disallowed in criminal cases and civil cases involving common law fraud in the United Kingdom, it has not been ruled out in United Kingdom civil cases that do not involve deception. It has also been applied in some Australian cases where common law fraud was not at issue. In at least one Australian case the defendant's liability for fraudulent misrepresentation was established through

¹⁰² *Corporations Act 2001* (Cth) s 1043A(1)(b).

¹⁰³ See above n 50 and accompanying text.

the application of the aggregation principle. The doctrine has also been adopted in the *Criminal Code Act 1995* (Cth) for the purpose of establishing a corporation's liability for criminal negligence.

As the courts in *El Ajou* and *Tszyu* decided, a company will not lose its memory where it acquired the relevant knowledge through a servant, who left the company after making relevant business decisions with the knowledge acquired, if the company innocently implemented the decisions after the servant's departure. This ruling is potentially important for attributing insider trading liabilities to a company, given that this scenario could occur in relation to a servant's decision to trade on material inside information on behalf of the company